

In the matter of:)	
)	
MERRILL LYNCH, PIERCE, FENNER)	ADMINISTRATIVE CONSENT ORDER
& SMITH INCORPORATED,)	
)	
Respondent.)	File Number 09053

WHEREAS, solely for the purposes of terminating the multistate task force investigations, including the investigation by the Securities Commissioner of the State of South Carolina (the

1 "Securities Commissioner"), and in settlement of the issues contained in this Order, Merrill Lynch,
2 without admitting or denying the Statement of Facts and Conclusions of Law contained in this
3 Order, and without an adjudication of any issue of law or fact, consents to the entry of this Order.

4 NOW, THEREFORE, the Securities Commissioner, as administrator of the South Carolina
5 Uniform Securities Act of 2005 (the "Act"), hereby enters this Order:

6 I.

7 STATEMENT OF FACTS

8 A. Background Mechanics of Auction Rate Securities.

9 1. ARS as a general term refers to long-term debt or equity instruments tied to short-
10 term interest rates that are reset periodically through an auction process.

11 2. At auction, ARS always trade at par, with the yield of the instruments being
12 adjusted by the movements of interest rates set by Dutch auction.

13 3. At an ARS Dutch auction, a security holder has three options, the holder can: (1)
14 hold; (2) purchase or sell; or (3) purchase and hold at rate.

15 4. Investors looking to acquire ARS bid into the auction at the rate and quantity that
16 they are willing to hold the securities.

17 5. Orders for the available quantity of ARS are then filled, starting with the lowest bid
18 rate up until all the shares offered for sale in the auction are allocated.

19 6. The rate at which the final share from the auction is allocated is the clearing rate,
20 and sets the rate to be paid for the entire issue until the next auction.

21 7. If there are not enough purchasers the auction fails, no shares change hands, and the
22 rate resets to a rate that is prescribed in the instrument's offering documents.

23 B. Merrill Lynch Marketed And Sold Auction Rate Securities As Safe, Liquid
24 Short-Term Investments.

- 25 1. Merrill Lynch Marketed Auction Rate Securities as Safe, Liquid
26 Investments.

1 8. Merrill Lynch marketed and sold ARS as money market like instruments, which
2 were safe and liquid.

3 9. Merrill Lynch additionally used research pieces to market ARS to customers.

4 10. Financial advisers ("FAs") would often forward Merrill Lynch marketing pieces to
5 customers to reassure them of the safety and value of the instruments.

6 11. FAs who sold ARS were not required to provide customers with disclosures, instead
7 purchasers would receive trade confirmations directing the purchasers to where they could access
8 Merrill Lynch's "Auction Rate Practices and Procedures."

9 12. On March 15, 2006, Merrill Lynch ended its practice of sending ARS purchasers a
10 "Master Purchasers Letter." The Master Purchasers Letter was a disclosure document that all
11 purchasers of ARS had been required to sign and return to Merrill Lynch.

12 13. Merrill Lynch's policies and procedures did disclose some important elements of its
13 ARS program, including that Merrill Lynch plays multiple roles in the ARS market, that Merrill
14 Lynch's interest may differ from those of its clients who purchase ARS, that Merrill Lynch is
15 permitted but not obligated to submit orders for its own account and routinely does, and that a
16 purchaser's ability to sell the purchaser's ARS may be limited.

17 14. Yet, since Merrill Lynch FAs were not required to affirmatively disclose these
18 practices prior to selling a client an ARS, purchasers were largely unaware of Merrill Lynch's
19 practices in supporting its ARS program.

20 15. Merrill Lynch did not undertake any analysis of whether any customers actually
21 went to the website discussing its practices and procedures to review them.

22 2. Merrill Lynch Used the ARS' AAA Rating as a Selling Point for the ARS
23 Even After it had Allowed to Fail Certain AAA Rated ARS.

24 16. The fact that its ARS carried a AAA rating was an important marketing point for
25 Merrill Lynch. The AAA rating on ARS was routinely touted in marketing materials, as well as
26 research pieces that discussed ARS and their safety.

 17. Marketing materials produced by the ARS desk promoted ARS as follows:

- Auction Market Securities provide many advantages for investors
 - Large and liquid market with over \$306 billion currently outstanding
 - High quality credits with over 92% of the market rated AAA
 - Incremental yield to comparable securities such as commercial paper and money market funds
 - Taxable, tax advantaged and tax exempt investment options

18. A AAA rating is a long term credit rating.

19. A number of the collateralized debt obligations ("CDOs") and other ARS underwritten and offered by Merrill Lynch carried a AAA rating from major rating agencies.

20. The AAA rating on Merrill Lynch's ARS did not speak to an investor's ability to liquidate the instrument through auction at par.

21. In August 2007, as described below, Merrill Lynch ceased supporting the auctions of a number of its AAA rated ARS.

22. Those securities became illiquid and subsequently lost most of their market value.

23. Despite the fact a number of Merrill Lynch marketed AAA ARS auctions failed in August 2007, subsequent to August 2007, Merrill Lynch continued to use the AAA rating as a selling point for ARS.

24. Merrill Lynch was aware--yet did not disclose to investors--that certain ARS retained their AAA rating after auctions of the securities had failed.

25. Merrill Lynch was aware--yet did not disclose to investors--that a AAA rating did not provide protection against Merrill Lynch deciding to no longer support auctions of Merrill Lynch marketed ARS.

26. Nonetheless, Merrill Lynch relied heavily on the AAA rating to convince investors the ARS it was selling were safe and principal protected.

C. Merrill Lynch's ARS Program Stands in Contrast to its Representations to Customers.

1. Merrill Lynch's ARS Program Provided Issuers with Inexpensive Financing and Generated Substantial Fees for Merrill Lynch.

1 27. Merrill Lynch's ARS program was funded by issuers of ARS, who paid Merrill
2 Lynch fees to underwrite securities and remarket them.

3 28. The ARS market allowed issuers to achieve long-term financing at short-term rates.

4 29. The Merrill Lynch ARS program had four branches, an investment bank that
5 underwrote ARS, the ARS desk that acted as a remarketing agent for the securities, a sales force
6 that sold ARS to retail and other clients, and a research division that assisted the ARS desk in
7 placing ARS.

8 30. The ARS that Merrill Lynch underwrote then sold to its clients consisted of auction
9 preferred shares ("APS"), with perpetual maturity, with dividends that reset every 7 to 35 days at
10 auction, or long-term debt instruments, issued by municipalities and student loan organizations
11 with maturities of twenty to forty years with interest rates that reset through the same process.

12 31. Due to the upward sloping yield curve, issuers of long-term instruments would
13 typically have to pay higher interest rates.

14 32. By supporting the auction mechanism, both in its role as a remarketing agent and by
15 purchasing ARS at auction to avoid failures, Merrill Lynch allowed issuers to have long-term
16 financing at short-term rates.

17 33. Purchasers of ARS were willing to accept short-term rates because they believed
18 they would have access to their principal on short-term notice at the next auction, and they would
19 get a slightly higher rate than a money market fund because they would have to wait until the next
20 auction to access their money.

21 34. This belief was cultivated by Merrill Lynch and other broker-dealers who used their
22 own capital to ensure auctions did not fail, and generally touted the twenty-year track record of
23 very rare failures, creating the impression with investors that there was a deep liquid market for the
24 securities.

25 35. Due to the practice of Merrill Lynch and other broker-dealers of placing support
26 bids, for the twenty years prior to August of 2007, there had been only a handful of failed auctions
 that prevented investors from accessing their principal.

1 2. Merrill Lynch Generated Significant Fees by Underwriting ARS with
2 Constrictive Maximum Rates and Selling them to Clients.

3 a. Merrill Lynch Generated Significant Fees Underwriting ARS and
4 Distributing Them To Clients.

5 36. The investment bank at Merrill Lynch generated significant fees from underwriting
6 new issuances of ARS. From 2001 through 2008 Merrill Lynch underwrote approximately \$13
7 billion of APS, earning \$130 million of underwriting fees.

8 37. In order to help move new issues Merrill Lynch awarded FAs who placed new ARS
9 issues with placement credits.

10 b. Merrill Lynch Underwrote ARS With Constrictive Maximum Rates,
11 Which Allowed The Securities To Achieve AAA Ratings.

12 38. Upon information and belief, 92% of the ARS that Merrill Lynch underwrote
13 received a AAA rating from rating agencies such as Fitch and Moody's, and 97% had ratings of
14 AA or better.

15 39. AAA ratings from agencies such as Fitch and Moody's signify the rating agencies'
16 assessment that there is a high likelihood that the security will pay interest or dividends as well as
17 principal when due in a timely manner.

18 40. Maximum rate provisions place a ceiling on the rate of interest at which an auction
19 can clear, and additionally provide the rate the issuer must pay should auctions fail.

20 41. When evaluating whether an issuer could make payments as due on its ARS, rating
21 agencies would look at the terms of the instrument to determine how much interest the issuer might
22 be obligated to pay. The existence of a maximum rate provision places an absolute cap on the
23 interest or dividend an instrument will pay, restricting its potential obligations, and making it easier
24 for the instrument to achieve a AAA rating.

25 42. Once Merrill Lynch stopped placing support bids in the auctions for which it was
26 the lead broker-dealer, there were auction failures across its program.

 43. When auctions fail the rate resets to the maximum rate.

1 44. The ARS with high maximum rates, typically municipal auction rate certificates
2 ("ARCS") with maximum rates in the range of 12-15%, have drawn investor interest and have
3 cleared without Merrill Lynch's support.

4 45. The ARS with low maximum rates, typically taxable and tax-exempt APS with
5 maximum rates in the range of 3-5%, have not drawn investor interest and without Merrill Lynch's
6 support have continued to fail, leaving investors with illiquid instruments.

7 c. Merrill Lynch Additionally Received Fees To Remarket The ARS It
8 Underwrote.

9 46. When Merrill Lynch underwrote an issue of ARS, it typically served as the broker-
10 dealer or remarketing agent for the issue.

11 47. Merrill Lynch would typically receive a fee of 25 basis points of the value of the
12 ARS for which it acted as remarketing agent.

13 48. Merrill Lynch would share a portion of this fee with FAs in order to incentivize
14 them to place clients into ARS.

15 49. Prior to every auction for which Merrill Lynch was the sole or lead broker-dealer,
16 Merrill Lynch would provide "price talk," a range of bids provided to FAs indicating where Merrill
17 Lynch expected auctions to clear.

18 50. All ARS for which Merrill Lynch acted as sole broker-dealer were placed through
19 Merrill Lynch FAs.

20 51. Under Merrill Lynch's ARS program, as remarketing agent, the ARS desk had the
21 option but not the obligation to bid in auctions.

22 52. Until August of 2007 Merrill Lynch had a policy of placing support bids into every
23 auction for which it was sole or lead broker-dealer.

24 53. In August of 2007 Merrill Lynch withdrew its support for certain CDO-backed
25 ARS.

26 54. When placing a support bid, Merrill Lynch would bid for the entire notional value
of the issue being auctioned, regardless of the size or volume of buy, sell, or hold orders Merrill

1 Lynch had received.

2 55. By placing support bids for the entire notional value of the issue being auctioned,
3 Merrill Lynch ensured that no auctions in its ARS program would fail.

4 56. Merrill Lynch often set the rate at which the auctions would clear with its support
5 bids.

6 57. For the period of January 3, 2006, through May 27, 2008, 5892 auctions for which
7 Merrill Lynch was the sole lead dealer would have failed but for Merrill Lynch's support bids.

8 58. Investors were not provided with information about the volume of shares that
9 moved at auction.

10 59. Investors were not provided with information about the level of support from
11 Merrill Lynch that was required to clear auctions.

12 60. Investors were not informed of how many ARS Merrill Lynch was carrying on its
13 own inventory as a result of supporting auctions.

14 **D. ARS Inventory Concerns At Merrill Lynch**

15 1. Weakness in the Credit Markets Initiated Inventory Concerns In Summer Of
16 2007.

17 61. Beginning in late July 2007, certain negative market influences surrounding CDOs
18 and collateralized loan obligations ("CLOs") and a credit crunch began to negatively impact
19 Merrill Lynch's CDO and CLO auction market business.

20 62. As investors began selling CDO and CLO ARS due to concerns about credit quality
21 (despite the fact that many were AAA rated), Merrill Lynch purchased the ARS into its own
22 inventory to make sure auctions did not fail.

23 63. At a certain point, Merrill Lynch decided to limit the amount of inventory of these
24 ARS instruments it was taking on and ceased submitting support bids, thus allowing auctions to
25 fail.

26 64. Merrill Lynch FAs began to seek answers to questions concerning ARS as early as
August 7, 2007.

1 65. FAs from all over the United States sent emails and made telephone calls to request
2 information from the Global Markets & Investment Banking staff managing the Merrill Lynch
3 Auction Trading Desk.

4 66. The Auction Desk and the Financial Products Group, along with several of the
5 supposedly independent research analysts for closed-end funds and Fixed Income/Cash, organized
6 and participated in sales calls during the second and third week of August 2007 in an effort to clear
7 auctions, reduce the rates of important issuers, and maintain a strong interest in ARS among the
8 Merrill Lynch FAs all over the country.

9 2. Communications With Issuers And Others Expressing Concern About The
10 Auction Markets.

11 67. As early as August 3, 2007, senior management of Merrill Lynch requested a
12 sample term sheet for Auction Market Preferred Shares ("AMPS") to understand the liquidity and
13 downgrade risk.

14 68. In August 2007, representatives from major issuers in the closed-end fund
15 investment world were also trying to get a sense of the risks and demand reductions for their
16 preferred shares.

17 69. None of these growing risks concerning weak demand in the ARS market were
18 disclosed to Merrill Lynch clients during the third quarter of 2007.

19 70. Upon information and belief, Merrill Lynch began, in late 2007, discussing with
20 issuers, concerns with the auction markets.

21 3. Merrill Lynch Surpasses Its Inventory Limit In September 2007, As ARS
22 Market Conditions Worsened.

23 71. In late September 2007, inventory levels rose significantly and the Auction Desk
24 was fast approaching its limit of \$1 billion dollars.

25 72. In addition, Merrill Lynch had certain lenders that provided financing for its
26 inventory of ARS.

 73. Those lenders had previously accepted ARS as collateral for the loans.

1 74. In the Fall of 2007, certain of these lenders became uncomfortable with the liquidity
2 of ARS and ceased accepting them as collateral.

3 75. Merrill Lynch did not inform its retail and other customers, to whom it was
4 marketing ARS as principal protected cash-like instruments, that entities that financed its inventory
5 no longer accepted certain ARS (even some rated AAA) as collateral.

6 **E. Merrill Lynch's Consolidated Effort to Reduce Inventory – A Three Pronged**
7 **Approach.**

8 1. Calming Fears, Providing Assurances And Motivating Additional Sales Of
9 ARS Through Sales Calls with FAs.

10 76. Just after the first hint of investor concern with the auction market, the Auction
11 Desk and Sales and Trading immediately mobilized to stem the tide of negative news. Managers
12 moved quickly to set up sales calls to provide assurances to FAs and to motivate future sales of
13 ARS.

14 77. In late November and early December 2007, with inventory backing up and
15 reaching new highs at Merrill Lynch, a decision was made to do another national sales call. The
16 formula would be similar to the successful call made previously in August. Auction Desk
17 personnel would be joined by a member or members of the Research Department to reassure and
18 motivate FAs to concentrate on selling Auction Desk inventory.

19 78. During the call, there was no discussion regarding the risk of any type of auction
20 failure, or the likelihood or possibility that any market dislocation could result in retail customers'
21 ARS becoming illiquid.

22 79. Moreover, there was no discussion about the possibility that Merrill Lynch could
23 decide at any time to stop its support of the auction market or to otherwise withdraw from
24 supporting the auctions that it solely managed or co-managed.

25 80. There was no mention of the fact that with the pressures that existed in the credit
26 market since August 2007, any auction failure by any auction dealer could spread contagion to the
rest of the market.

2. FA Incentives - Increased Production Credits Sales Drive.

1 81. At various times during the second half of 2007, Merrill Lynch provided incentives
2 in the form of enhanced production credits as a means of motivating FAs to sell ARS to customers
3 and reduce Merrill Lynch's inventory. Typically, FAs earned 12.5 basis points ("bps") on an
4 annualized basis for investments in ARS. FAs would then earn a percentage of the 12.5 bps
5 according to a payout grid.

6 82. During periods where enhanced credits were awarded, FAs could earn as much as 8
7 times that amount (or 100 bps) for sales of ARS. Other enhanced payouts could include payouts of
8 25 bps, or 50 bps. Similar to regular production credits earned, FAs enhanced production credits
9 would be applied to the grid resulting in FAs being paid a certain predetermined percentage of the
10 enhanced production credit.

11 3. Coordination with Research

12 a. Proactive Involvement From The Supposedly Independent Research
13 Department To Aid In Sales Efforts.

14 83. Merrill Lynch's Research Department played a pivotal role in assisting sales of
15 ARS.

16 84. On at least two occasions during the Fall of 2007, Sales and Trading and the
17 Auction Desk made direct and specific requests for the Research Department to draft favorable
18 research pieces regarding the auction market to assist in sales.

19 b. Improper Information Sharing Between Research and Sales and
20 Trading.

21 85. The task force's investigation revealed frequent communications among research,
22 sales, and trading staff.

23 86. Merrill Lynch Policy & Procedures Manual (the "Policies Manual") employs a so-
24 called "Chinese Wall," which is designed to prevent "the misuse of material non-public
25 information" and to prevent "even the appearance of impropriety."

26 87. The "Chinese Wall" is designed to "restrict and monitor the flow of information
between the various areas of [Merrill Lynch] such as Global Research, Sales [and] Trading,"

1 among others "to avoid the misuse of such information and the appearance of impropriety as well
2 as to manage potential conflicts of interest..."

3 88. Those departments that constitute the "Private Side of the Wall" include
4 "Investment Banking, including Global Capital Markets and Financing (Equity Capital Markets
5 and Debt Capital Markets)," and "other departments or individuals that regularly receive inside
6 information," while the Research Division is on the "Public Side of the Wall."

7 89. Among the categories of information that could not be discussed between Sales or
8 Trading and Research are the levels or amounts of inventory that Merrill Lynch maintained for its
9 own account.

10 90. Such information was discussed.

11 **F. Improper Influence And Pressure Over Supposedly Independent Research**
12 **Personnel.**

13 91. Merrill Lynch permitted its Sales and Trading and Auction Desk personnel to have
14 undue influence over its Research Department regarding its coverage of the auction market.

15 92. In addition to the direct requests of Sales and Trading and the Auction Desk to
16 Research for positive published material related to the auction market, undue influence was also
17 exercised over the content of the published research reports.

18 93. Other times, Auction Desk Personnel attempted to directly influence how Research
19 responded to I A questions during sales calls.

20 **G. Events Leading To Merrill Lynch's Decision To Stop Broadly Supporting Its**
21 **Auction Program.**

22 94. Concerns surrounding the auction market grew more ominous going into the new
23 year and Merrill Lynch's Auction Desk personnel began to brace for the worst.

24 95. Likewise, inventory concerns at Merrill Lynch continued.

25 96. On January 23, 2008, word began circulating among broker-dealers that Lehman
26 Brothers had a number of auctions fail the previous day.

97. Concerns were not shared with FAs or retail customers.

1 98. Between the dates February 1, 2008, and February 8, 2008, staff wrote or
2 contributed to approximately three published research pieces, including: Fixed Income Digest,
3 "Preserve income: lock in yields"; Fixed Income Digest Supplement, "Auction Market Securities";
4 and Auction Market Value Sheet, "Back to Basics in the Auction Market." Each of these
5 publications continued to recommend that investors should feel confident about the auction market.

6 99. On or about February 1, 2008, Merrill Lynch's Research Department published a
7 volume of its Fixed Income Digest, entitled "Preserve income: lock in yields." The cover page
8 included a section entitled "Preserve income." The last sentence of the section provided: "For
9 funds that investors need to keep liquid, we continue to find the best value in auction market
10 securities." Inside the research piece, there was a subheading: "For cash holdings: auction market
11 securities," which recommended, "[n]aturally, most investors need to keep some portion of their
12 portfolios in liquid cash-like instruments. We find auction market securities (AMS) to be a better
13 alternative than money funds for these purposes for investors with larger amounts to invest." The
14 section was followed immediately by another section dedicated to: "Answering your questions
15 about auction market securities" which responded to common questions relating to the auction
16 markets at the time.

17 100. On February 4, 2008, the Research Department re-published the "Answering
18 Questions" piece on its own as a supplement to the Fixed Income Digest, in part because of
19 questions the Research Department was getting on calls and because FAs were likely having a
20 problem locating the information in the otherwise lengthy February 1, 2008, publication.

21 101. On the evening of February 12, 2008, Merrill Lynch executives decided to cease
22 supporting its ARS program and intentionally allowed the vast majority of their auctions to fail the
23 following day.

24 102. Merrill Lynch's decision to stop broadly supporting its auction program was made
25 without any real consideration or analysis of its effect on retail and other investors holding the
26 securities.

1 2. This Order is entered into solely for the purpose of resolving the referenced multi-state
2 investigation, and is not intended to be used for any other purpose.

3 3. Merrill Lynch will CEASE AND DESIST from violating the Act and will comply with
4 the Act.

5 4. Merrill Lynch shall pay fines and/or penalties totaling \$125 million (the "Total
6 Penalty") to the Commonwealth of Massachusetts and the other states, which shall be allocated at
7 the Commonwealth of Massachusetts and the other states' discretion, to resolve all underlying
8 conduct relating to the sale of ARS by Merrill Lynch. Merrill Lynch shall pay \$1,312,134.30 of
9 the Total Penalty to the Securities Division of the Office of the Attorney General of the State of
10 South Carolina (the "Securities Division"). In the event another state securities regulator
11 determines not to accept Respondents' settlement offer, the total amount of the payment to the
12 Securities Division shall not be affected, and shall remain at \$1,312,134.30.

13 5. Definitions and Buyback Offer. Merrill Lynch will provide liquidity to Eligible
14 Investors by buying Eligible Auction Rate Securities that have failed at auction at least once
15 between February 13, 2008, and the date of this Offer, at par, in the manner described below.

16 "Eligible Auction Rate Securities," for purposes of this Order, shall mean ARS publicly
17 issued by municipalities or closed-end funds or backed by student loans and purchased at Merrill
18 Lynch on or before February 13, 2008. Notwithstanding any other provision, Eligible Auction
19 Rate Securities shall not include privately issued or placed ARS that are unregistered and/or
20 offered pursuant to SEC Rule 144A, or other exemptions of the Securities Act of 1933.

21 "Eligible Investors," for purposes of this Settlement, shall mean:

22 (i) Natural persons (including their IRA accounts, testamentary trust and estate
23 accounts, custodian UGMA and UTMA accounts, and guardianship accounts) who purchased
24 Eligible Auction Rate Securities at Merrill Lynch; and

25 (ii) All small business and not for profit clients in Merrill Lynch's Global Wealth
26 Management Group who purchased Eligible Auction Rate Securities at Merrill Lynch that had
\$100 million or less in assets in their accounts with Merrill Lynch, net of margin loans, as of

1 August 7, 2008, or, if the customer was not a customer of Merrill Lynch as of August 7, 2008, as of
2 the date that the customer terminated its customer relationship with Merrill Lynch.
3 Notwithstanding any other provision, "small business and not for profit clients" does not include
4 broker-dealers or banks acting as conduits for their customers.

5 6. Tranche I Eligible Investors. No later than September 26, 2008, Merrill Lynch shall
6 have offered to purchase at par, plus any accrued but unpaid interest or dividends, Eligible Auction
7 Rate Securities for which auctions are not successfully auctioning from Eligible Investors who had
8 less than \$4 million in assets at Merrill Lynch as of August 7, 2008. Merrill Lynch's offer to
9 purchase such securities from Eligible Investors will remain open from October 1, 2008, through
10 January 15, 2010, and Merrill Lynch shall promptly purchase such securities from any Eligible
11 Investor who accepts this offer between January 2, 2009, and January 15, 2010.

12 For purposes of this Settlement, legal entities forming an investment vehicle for closely
13 related individuals, including but not limited to IRA accounts, Trusts, Family Limited Partnerships
14 and other legal entities performing a similar function, charities and non-profits, and small
15 businesses who had less than \$4 million in assets at Merrill Lynch shall be covered by Section
16 III.5(i).

17 7. Tranche II Eligible Investors. No later than December 18, 2008, Merrill Lynch shall
18 have offered to purchase at par, plus any accrued but unpaid interest or dividends, Eligible Auction
19 Rate Securities from other Eligible Investors who purchased Eligible Auction Rate Securities from
20 Merrill Lynch prior to February 13, 2008, and who had less than \$100 million in assets at Merrill
21 Lynch as of August 7, 2008.

22 Merrill Lynch's offer to purchase such securities from Eligible Investors shall remain open
23 from January 2, 2009 through January 15, 2010, and Merrill Lynch shall promptly purchase such
24 securities from any investor who accepts this offer between January 2, 2009, and January 15, 2010.

25 8. Asset Amounts. Merrill Lynch shall calculate investor asset amounts as of August
26 7, 2008, for all Eligible Investors with assets with Merrill Lynch as of that date. For Eligible

1 Investors with no assets at Merrill Lynch as of that date, Merrill Lynch shall calculate investor
2 asset amounts as of the date such investor removed their assets from Merrill Lynch.

3 9. Notice and Assistance. Merrill Lynch shall provide prompt notice to customers of
4 the settlement terms, and Merrill Lynch shall establish a dedicated telephone assistance line, with
5 appropriate staffing, to respond to questions from customers concerning the terms of the
6 settlement.

7 10. Relief for Eligible Investors Who Sold Below Par. No later than October 1, 2008,
8 any investor covered by Section III.5 that Merrill Lynch can reasonably identify who sold Eligible
9 Auction Rate Securities below par between February 13, 2008, and October 1, 2008, shall be paid
10 by Merrill Lynch the difference between par and the price at which such investor sold the Eligible
11 Auction Rate Securities.

12 11. Consequential Damages Claims. No later than October 1, 2008, Merrill Lynch shall
13 make reasonable efforts promptly to notify those Eligible Investors covered by Section III.5 above
14 who own Eligible Auction Rate Securities, pursuant to the terms of the settlement, that an
15 independent arbitrator, under the auspices of the Financial Industry Regulatory Authority
16 ("FINRA"), shall be available for the exclusive purpose of arbitrating any Eligible Investor's
17 consequential-damages claim. Merrill Lynch shall consent to participate in the North American
18 Securities Administrators Association's ("NASAA") Special Arbitration Procedures (the "SAP")
19 established specifically for arbitrating any Eligible Investor's consequential damages claim arising
20 from their inability to sell Eligible Auction Rate Securities. Nothing in this Offer shall serve to
21 limit or expand any party's rights or obligations as provided under the SAP. Arbitration shall be
22 conducted before a single non-industry arbitrator and Merrill Lynch will pay all forum and filing
23 fees.

24 Arbitrations asserting consequential damages of less than \$1 million will be decided
25 through a single chair-qualified public arbitrator who will be appointed through the FINRA list
26 selection process for single arbitrator cases. In arbitrations where the consequential damages

1 claimed are greater than or equal to \$1 million, the parties can, by mutual agreement, expand the
2 panel to include three public arbitrators who will be appointed through FINRA's list procedure.

3 Any Eligible Investors who choose to pursue such claims through the SAP shall bear the
4 burden of proving that they suffered consequential damages and that such damages were caused by
5 their inability to access funds invested in Eligible Auction Rate Securities at Merrill Lynch as of
6 February 13, 2008. In the SAP, Merrill Lynch shall be able to defend itself against such claims;
7 provided, however, that: Merrill Lynch shall not contest liability for the illiquidity of the
8 underlying ARS position or use as part of its defense any decision by an Eligible Investor not to
9 borrow money from Merrill Lynch. Special or punitive damages shall not be available in the SAP¹.

10 All customers, including but not limited to Eligible Investors who avail themselves of the
11 relief provided pursuant to this Order, may pursue any remedies against Merrill Lynch available
12 under the law. However, Eligible Investors that elect to utilize the SAP are limited to the remedies
13 available in that process and may not bring or pursue a claim relating to Eligible Auction Rate
14 Securities in another forum.

15 12. Institutional Investors Not Covered By Section III.5. Merrill Lynch shall endeavor
16 to continue to work with issuers and other interested parties, including regulatory and other
17 authorities and industry participants, to expeditiously and on a best efforts basis provide liquidity
18 solutions for investors who purchased Eligible Auction Rate Securities from Merrill Lynch and are
19 not entitled to participate in the buyback described in Section III.5 above (referred to herein as
20 "Institutional Investors").

21 Beginning January 2, 2009, and then quarterly after that, Merrill Lynch shall submit a
22 written report to a representative specified by NASAA outlining the efforts in which Merrill Lynch
23 has engaged and the results of those efforts with respect to Merrill Lynch Institutional Investors'
24 holdings in Eligible Auction Rate Securities. Merrill Lynch shall confer with the representative no
25 less frequently than quarterly to discuss Merrill Lynch's progress to date. Such quarterly reports

26 ¹ However, it is agreed by the parties that "consequential damages" shall have a meaning separate and apart
from "punitive or special damages." Under no circumstances should this provision be read to mean that a
consequential damages claim may not be maintained due to any state law which may categorize consequential damages
as a subset within punitive and/or special damages.

1 shall be submitted within 20 days following the end of each quarter and continue until no later than
2 January 15, 2010. Following every quarterly report, the representative shall have the option of
3 requiring a meeting between the State and Merrill Lynch to advise Merrill Lynch of any concerns
4 and, in response, Merrill Lynch shall detail the steps that Merrill Lynch plans to implement to
5 address such concerns. The reporting or meeting deadlines set forth above may be amended with
6 written permission from the representative.

7 13. Relief for Municipal Issuers. Merrill Lynch shall refund refinancing fees to
8 municipal auction rate issuers that issued such Eligible Auction Rate Securities in the initial
9 primary market through Merrill Lynch between August 1, 2007, and February 13, 2008, and
10 refinanced those securities through Merrill Lynch after February 13, 2008. Refinancing fees are
11 those fees paid to Merrill Lynch in connection with a refinancing and are exclusive of legal fees
12 and any other fees or costs not paid to Merrill Lynch in connection with the transaction.

13 14. No Disqualification. This Order, which is entered pursuant to Merrill Lynch's offer
14 to repurchase Eligible Auction Rate Securities from Eligible Investors, hereby waives any
15 disqualification contained in the laws of the State of South Carolina, or rules or regulations
16 thereunder, including any disqualifications from relying upon the registration exemptions or safe
17 harbor provisions that Merrill Lynch or any of its affiliates may be subject to. This Order, which is
18 entered pursuant to Merrill Lynch's offer to repurchase Eligible Auction Rate Securities from
19 Eligible Investors, also is not intended to subject Merrill Lynch or any of its affiliates to any
20 disqualifications contained in the federal securities laws, the rules and regulations thereunder, the
21 rules and regulations of self regulatory organizations or various states' or U.S. Territories'
22 securities laws, including, without limitation, any disqualifications from relying upon the
23 registration exemptions or safe harbor provisions. In addition, this Order is not intended to form
24 the basis for any such disqualifications.

25 15. Nothing herein shall preclude the State of South Carolina, its departments, agencies,
26 boards, commissions, authorities, political subdivisions and corporations (collectively, "State
Entities"), other than the Securities Commissioner and only to the extent set forth in paragraph 1

1 above, and the officers, agents or employees of State Entities from asserting any claims, causes of
2 action, or applications for compensatory, nominal and/or punitive damages, administrative, civil,
3 criminal, or injunctive relief against Merrill Lynch in connection with any of the ARS sales
4 practices at Merrill Lynch.

5 16. For any person or entity not a party to this Order, Merrill Lynch's offer of
6 settlement and this Order do not limit or create any private rights or remedies against Merrill Lynch
7 including, without limitation, the use of any e-mails or other documents of Merrill Lynch or of
8 others for ARS sales practices, limit or create liability of Merrill Lynch, or limit or create defenses
9 of Merrill Lynch, to any claims.

10 17. In consideration of the Settlement the Securities Commissioner will:

11 a. Except as allowed by paragraph 17(b), terminate the investigation by the Securities
12 Commissioner and any other action that the Securities Commissioner could commence on behalf of
13 the State of South Carolina as it relates to Merrill Lynch's underwriting, marketing, and sales of
14 Eligible Auction Rate Securities, provided, however, that excluded from and not covered by this
15 paragraph are any claims by the Securities Commissioner arising from or relating to the "Order"
16 provisions contained herein.

17 b. Refrain from taking legal action, if necessary, against Merrill Lynch for previous
18 sales of ARS products to Institutional Investors until a date after December 31, 2009.

19 c. Not seek additional monetary penalties from Merrill Lynch relating to the issues
20 raised by the Securities Commissioner relating to Merrill Lynch's marketing and sale of Eligible
21 Auction Rate Securities to investors and the firm permitting trading in ARS by any individuals
22 affiliated with Merrill Lynch.

23 18. Failure to Comply With Terms of Settlement. If after this settlement is executed,
24 Merrill Lynch fails to comply with any of the terms set forth herein, the State may institute, at its
25 discretion, either an action to enforce this Order or an action to vacate the Order. If the State
26 chooses to vacate the Order, upon issuance of an appropriate order, after an opportunity for a fair
hearing, the State may reinstitute the actions and investigations referenced in this Order.

19. This Order and any dispute related thereto shall be construed and enforced in accordance with, and governed by, the laws of South Carolina without regard to any choice of law principles.

20. This Order shall be binding upon Merrill Lynch and its successors and assigns as well as to successors and assigns of relevant affiliates with respect to all conduct subject to the provisions above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events, and conditions.

Dated this 31 day of August, 2009.

BY ORDER OF THE SECURITIES COMMISSIONER

Kenny D. McMaster

HENRY D. McMASTER
SECURITIES COMMISSIONER
STATE OF SOUTH CAROLINA

1 **CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY MERRILL LYNCH**

2 Merrill Lynch hereby acknowledges that it has been served with a copy of this Administrative
3 Consent Order ("Order"), has read the foregoing Order, is aware of its right to a hearing and appeal in
4 this matter, and has waived the same.

5 Merrill Lynch admits the jurisdiction of the Securities Commissioner, neither admits nor
6 denies the Statement of Facts and Conclusions of Law contained in this Order; and consents to entry
7 of this Order by the Securities Commissioner as settlement of the issues contained in this Order.

8 Merrill Lynch agrees that it shall not claim, assert, or apply for a tax deduction or tax credit
9 with regard to any state, federal or local tax for any administrative monetary penalty that Merrill
10 Lynch shall pay pursuant to this Order.

11 Merrill Lynch states that no promise of any kind or nature whatsoever was made to it to induce
12 it to enter into this Order and that it has entered into this Order voluntarily.

13 Teresa M. Brenner represents that he/she is Associate General
14 Counsel of Merrill
15 Lynch and that, as such, has been authorized by Merrill Lynch to enter into this Order for and on
16 behalf of Merrill Lynch.

17 Dated this 20th day of August, 2009.

18 MERRILL LYNCH, PIERCE, FENNER & SMITH
19 INCORPORATED

20 By: Teresa M. Brenner
21 Title: Associate General Counsel

22 STATE OF NORTH CAROLINA, COUNTY OF MECKLENBURG
23 SUBSCRIBED AND SWORN TO before me this 20th day of August, 2009.

24 James E. Diggins
25 Notary Public - James E. Diggins

26 My Commission expires: May 2, 2010

